United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLEE

ORIGINAL

76-5014

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For the Second Circuit

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P/S

In Re

ALRAC CORPORATION,

Debtor.

CARL E. BARNES,

Appellant,

against

ALRAC CORPORATION,

Debtor-Appellee.

RECEIVED
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SECOND CIRCUIT

Appeal from the United States District Court
for the District of Connecticut

BRIEF FOR APPELLEES

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Appeal from the United States District Court for the District of Connecticut

BRIEF FOR APPELLEES

Issues Presented

The instant appeal presents two issues to be determined:

1. Did the United States District Court for the District of Connecticut ("District Court") err in determining and affirming that the bankruptcy court did not abuse its discretion in finding that (a) the needs of Alrac Corporation

("Alrac"), a debtor under Chapter XI of the Bankruptcy Act, were adequately served by the provisions of Chapter XI of the Act, and (b) conversion of the pending Chapter XI case to a case under Chapter X of the Bankruptcy Act was not proper?

2. Did the District Court err in determining that the findings of the bankruptcy court—that the Chapter XI plan proposed by Alrac was (a) accepted by the requisite majorities of each class of unsecured creditors affected thereby, and (b) for the best interests of creditors and feasible—were not clearly erroneous?

Preliminary Statement

Appellant, Carl E. Barnes ("Barnes"), the former Chief Executive Officer and Chairman of the Board of Directors of Alrac, appeals from an order of the District Court dated February 9, 1976 (the "Order"). The Order made by Chief Judge T. Emmet Clarie affirmed two orders of the bankruptcy court dated December 30 and December 31, 1974 respectively. The order of the bankruptcy court dated December 30, 1974, denied the motion made by Barnes and his wife, Sarah E. Barnes, pursuant to Section 328 of the Bankruptcy Act, 11 U.S.C. §728, and Chapter XI Rule 11-15, 415 U.S. 1015 (1974), to convert the Alrac Chapter XI case to a case under Chapter X of the Bankruptcy Act (the "Conversion Order"). The order of the bankruptcy court dated December 31, 1974, was made pursuant to Section 366 of the Bankruptcy Act, 11 U.S.C. §766, and confirmed the Chapter XI plan ("Plan") proposed by Alrac for the arrangement of its unsecured debts and liabilities ("Order of Confirmation").

Each argument presented by Barnes was previously heard in the District Court, and before that, in large measure, in the bankruptcy court. In each instance they were found to be without merit or substance. The District Court stated that it had

> "* * * carefully reviewed all of the transcripts of testimony given before the bankruptcy judge, the voluminous record in its entirety (including the correspondence from the Securities Exchange Commission, * * *), and all other relevant papers filed in [the] appeal; [and] * * * also studied the memoranda and briefs of counsel." (A469).*

Based upon its review, the District Court determined "(1) the bankruptcy judge made no 'clearly erroneous' findings of fact; (2) that the bankruptcy judge did not abuse his discretion in denying the petition to transfer the proceedings from Chapter XI to Chapter X; and (3) that the bankruptcy judge did not abuse his discretion in confirming the plan of arrangement." (A469). Accordingly, the District Court affirmed the orders made by Bankruptcy Judge Saul Seidman.

On this appeal, Barnes submits many arguments and contentions, but each of them in essence asks this Court to reweigh the facts found below and none of them explains why Alrac's creditors should experience any further delay before receiving the distributions provided for them under the confirmed Chapter XI Plan.** Significantly, Barnes never explains why Alrac's creditors would benefit mone-

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* Numbers in parentheses preceded by "A" refer to pages of the appendix.

** Once the Order of Confirmation becomes final, Alrac's disbursing agent can make total payments and distributions accumulated to date of approximately $659,000.

tarily, or otherwise, from a conversion to Chapter X or a reversal of the Order of Confirmation. The bankruptcy judge, however, carefully considered the arguments made by Barnes and rejected them in "well considered and reasoned memoranda." (A469). The District Court also carefully considered Barnes' contentions and likewise rejected them. Barnes has not presented any basis upon which the actions of the lower courts should be reversed and the expectations of Alrac's creditors frustrated.

This brief is submitted in opposition to the instant appeal by Alrac, the Official Creditors' Committee and Chevron Research Company ("Chevron"), the purchaser of the Nylon-4 patents and rights.

Statement of Facts

The facts which are pertinent to the appeal at bar as found by the bankruptcy court and set forth in the record, are as follows:

A. The Relationship of Barnes with Alrac and the Nylon-4 Patents

1. Barnes is a research chemist who in 1968 obtained a patent refining the basic patent of a product called "Nylon-4". (A300, 130, 135).

2. In 1968, Barnes formed a corporation, Alrac, with Harvey Wolfe and Herb Oscar Anderson to develop the Nylon-4 patents. (A300, 136, 137).

3. To overcome a working capital shortage, Alrac merged with Radiation Research Corporation, a corpora-

tion with approximately 1,500 public stockholders. The number of stockholders has not changed substantially since that time. (A300, 139, 140).

4. The name of the corporation was changed from Radiation Research Corporation to Alrac. (A300, 141).

5. To meet urgent capital needs, Alrac sold $3 million in subordinated debentures through Sterling, Grace & Co., Inc. (A300, 153-4, 156, 203).

6. In addition, Alrac subsequently raised additional moneys by issuing long-term notes aggregating $585,000 and, ultimately, borrowed $1,000,000 in short-term notes. (A300-1, 205-6).

7. Most of the money obtained by Alrac was loaned by "insiders" and friends and acquaintances of Barnes, primarily relying on his relationship to the invention and the operation of Alrac. (A300-1, 172, 206, 152-3).

8. The moneys raised by Alrac were insufficient to enable the development of the Nylon-4 Patents and Alrac was unable to meet the need for additional funding. (A302, 279).

B. The Relationship Between Alrac and Chevron

9. In 1973, Barnes and Wolfe decided to attempt a merger with a major corporation. Over twenty-five corporations were approached, but only Chevron evidenced an interest in Nylon-4. The only other interest expressed did not meet Alrac's urgent need for working capital to continue research and development of Nylon-4, a product not

yet available or suitable for commercial production. (A301, 179-80, 182, 207-10, 251-3, 473-4).

10. Negotiations by Alrac with Chevron resulted in certain agreements pursuant to which Chevron would acquire the Nylon-4 patents and pay to Alrac $450,000 on closing and $8,000,000 in annual installments of $500,000 beginning one year later, subject to an option to cancel during the first, third and sixth years. (A301, 478).

11. Barnes actively participated in the negotiations with Chevron but took issue with some of the terms finally agreed upon. He continued to hope a better deal "could be arrived at although no other major corporation showed any interest in any arrangement which would provide the necessary funding" to continue the development of the Nylon-4 patents. (A301, 183-6, 194-5, 210-2, 252).

12. The board of directors of Alrac outvoted Barnes and approved the execution of the agreements with Chevron then under consideration Barnes, as President of Alrac, signed the agreements on April 24, 1974, although he opposed the transaction. (A301, 186-93, 219).

13. On or about June 25, 1974, Barnes resigned as a director and Chief Executive Officer of Alrac. However, he continued to hold the office of president until two weeks later when he was removed "for cause". (A302, 197-9, 222, 475).

C. The Filing and Prosecution of the Chapter XI Petition by Alrac

14. On August 12, 1974, Barnes, together with his wife and a trade creditor, filed an involuntary petition in bankruptcy against Alrac. On August 20, 1974, Alrac filed a petition under Chapter XI, Section 321, of the Bankruptcy Act, 11 U.S.C. §721, Bankruptcy Rule 11-7, 415 U.S. 1012 (1974). (A299, 302, 477*).

15. Subsequent to the commencement of the Chapter XI case and in order to obtain the necessary funding to continue its business, Alrac applied to the bankruptcy court for authorization to enter into several agreements with Chevron including a License Agreement. Notice of the application was given to all known creditors in accordance with the provisions of the Bankruptcy Act and the directions of the bankruptcy court. Barnes appeared at the hearing and interposed objections to each of the agreements with Chevron. After due consideration, the bankruptcy court granted the application and the various agreements were authorized and approved. (A302, 263-4).

16. No appeal was taken by Barnes or any other party from the order authorizing the execution and delivery of the various agreements between Alrac and Chevron. (A303).

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* As a consequence of its worsening financial condition, Alrac was not in a position to proceed as originally contemplated by the agreements made April 24, 1974 with Chevron. Therefore, Alrac resumed negotiations with Chevron. On August 14, 1974 a series of new agreements were made with Chevron which included an agreement for the purchase of the Nylon-4 patents and anticipated the filing of a Chapter XI petition by Alrac. (A472-7).

17. As a result of the approval, execution, delivery and affirmation of the said agreements, Alrac obtained from Chevron the moneys necessary for continued operations. Without implementing the agreements, Alrac could not have continued its operations because of a total lack of funds. (A303, 237, 262-5).

D. The Chapter XI Plan

18. Consistent with the purposes of Chapter XI, *i.e.*, the settlement or extension of unsecured debt, a Creditors' Committee was organized by the creditors of Alrac to negotiate a Chapter XI plan. The Creditors' Committee was comprised of representatives of all classes of creditors and included Barnes' wife. (A303, 310, 261, 282-6).

19. Alrac and the Creditors' Committee engaged in negotiations as to the provisions of a Chapter XI plan. The attorney for Barnes was permitted to attend the meetings of the Creditors' Committee. After a series of negotiations and hard bargaining with the Creditors' Committee, the Plan was formulated, based upon the new agreements with Chevron dated August 14, 1974, which included the Purchase Agreement. (A303, 310, 261, 282-6).

20. The Chapter XI Plan as formulated divided the general unsecured creditors into three (3) classes:

Class I —Consisting of creditors (approximately $733,619) whose claims did not exceed $20,000. Claims up to $100 are to be paid in full. Those exceeding $100 are to receive $100 or 15% of their claims, whichever is greater.

Class II —Consisting of claims over $20,000 in amount, including short-term notes (approximately $1,277,224) and senior convertible 8½% notes (approximately $682,-973). Such claimants are to receive full payment in installments over seven years with interest to August 20, 1974, and a pro rata share of 750,000 shares of common stock of Alrac.

Class III —Consisting of claims of holders of convertible subordinated 7½% debentures ($2,215,000) issued by Alrac. Such claimants are to receive full payment in installments over eleven years with interest to August 20, 1974, and a pro rata share of 750,000 shares of common stock of Alrac. The rights of the claimants to convert their debentures to common stock of Alrac are preserved but the conversion price is reduced to $2 per share.

(A303, 358-61), as amended January 22, 1975.* (A303, 258-61).

21. On December 20, 1974, the Chapter XI Plan negotiated with the Creditors' Committee was accepted by an overwhelming majority of the creditors in Classes I and II and unanimously by Class III creditors. (A299, 304, 51-65).

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* By amendment dated January 22, 1975 (A319-20), the bankruptcy court corrected certain minor, inadvertent typographical errors contained in the Memorandum and Order. (A299 ff.). The corrections are reflected in the facts stated in this brief.

22. The Chapter XI Plan was amended to provide that the shares of common stock to be issued to creditors in Classes II and III would bear the following legend:

> "The shares represented by this certificate have not been registered under the Securities Act of 1933 and may not be sold, assigned or transferred unless a registration statement under the Securities Act of 1933 is in effect or an exemption from registration is available."

The amendment also required Alrac to use its best efforts to register the stock under the Securities Act of 1933 at its own expense within two years of the date of confirmation. (A304, 297-8, 270-4).

E. The Proceedings Below

23. On December 30, 1974, the bankruptcy judge, after consideration of the evidence adduced at the hearing held on December 26, 1974, rendered his decision and dismissed the Barnes conversion motion. The bankruptcy judge found:

a. Barnes himself had acknowledged the hopeless insolvency of Alrac and that no major corporation other than Chevron had come forward with any offer to purchase or otherwise provide for the research and development of the Nylon-4 patents. (A302, 306, 309, 180-3, 251-2).

b. There existed no equity for the stockholders as of the filing date. (A302, 314).

c. There existed no reasonable prospect for the formulation of any plan in a proceeding under Chapter

X other than the one already accepted by the creditors in the Chapter XI case. (A310-1, 313).

d. If the Chapter XI petition were dismissed, an adjudication in bankruptcy would follow, and Alrac's existence would be ended. (A310-1).

e. If the conversion motion were granted, there existed no reasonable prospect that Alrac could survive and the case would therefore be converted to a bankruptcy liquidation. (A311).

f. There existed no evidence of fraud or mismanagement suggesting the need for an independent investigation. Barnes himself was in charge of the affairs of Alrac until weeks prior to the filing. (A311-3).

g. The Securities and Exchange Commission had surveyed the situation and did not object to the Chapter XI case or the confirmation of the Plan. (A307, 313-4).

h. The good faith of Barnes is questionable. (A306, 479).

i. The needs of Alrac to be served "* * * are admirably met by the plan overwhelmingly accepted by the creditors affected. The equity of shareholders which was negative at the date of confirmation is preserved. The interests of the investing public are adequately protected. Since the needs to be served can be adequately satisfied in Chapter XI, it must be concluded that the proceedings need not have been brought under Chapter X of the Act, * * *." Accordingly, the conversion motion was dismissed. (A314).

24. As to Barnes' objections to confirmation, the bankruptcy court found:

a. The Plan had been accepted in writing by the creditors whose acceptance is required by law. Order of Confirmation, ¶1. (A315).

b. The Plan had "been proposed and its acceptance procured in good faith, and not by any means, promises, or acts forbidden by law, the provisions of Chapter XI of the Act had been complied with, the plan is for the best interests of the creditors and is feasible, the debtor has not been guilty of any of the acts or failed to perform any of the duties which would be a bar to the discharge of a bankrupt." Order of Confirmation, ¶2. (A315-6).

25. The Order of Confirmation also provided for the immediate transfer and vesting in Chevron of all of the property and other rights which are the subject of the Purchase Agreement dated August 14, 1974, and the attachments thereto. Order of Confirmation, ¶D. (A317-8).

26. Alrac allocated a portion of the initial payment of $450,000 made by Chevron pursuant to the Purchase Agreement dated August 14, 1974, to make the deposit of the consideration to be distributed to creditors upon confirmation as required by Section 362 of the Bankruptcy Act, 11 U.S.C. §762, Chapter XI Rule 11-38, 415 U.S. 1028 (1974). Order of Bankruptcy Judge Seidman, dated December 31, 1974, Authorizing and Directing Return of Moneys Advanced for Deposit by Chevron. (A4).

27. Barnes appealed to the District Court from the orders of December 30 and 31, 1974, denying the conversion motion and confirming Alrac's Chapter XI Plan. (A462).

28. The District Court affirmed the Conversion Order and the Order of Confirmation. (A462-70).

29. The District Court found that the Order of Confirmation "approved the sale and transfer of Alrac's Nylon-4 Patents to Chevron" and that since Barnes had not obtained a stay or filed a supersedeas bond under Chapter XI Rule 11-62, 415 U.S. 1038 (1974), the outcome of the appeal "cannot affect the sale of patents to Chevron." (A465).

30. District Judge Clarie read "the voluminous record in its entirety" and found:

> "(1) that the bankruptcy judge made no 'clearly erroneous' findings of fact; (2) that the bankruptcy judge did not abuse his discretion in denying the petition to transfer the proceedings from Chapter XI to Chapter X; and (3) that the bankruptcy judge did not abuse his discretion in confirming the plan of arrangement." (A469).

31. The Order provided that "the said appeals [of Barnes] are denied and dismissed, for the same reasons set forth in the well-considered and reasoned memoranda of the bankruptcy judge dated December 30, 1974 and December 31, 1974, as amended January 22, 1975. * * *" (A469).

ARGUMENT

I

THE DENIAL OF THE CONVERSION MOTION REPRESENTED A PROPER EXERCISE OF DISCRETION.

A. Adequate Relief for the Needs of Alrac Was Available Under Chapter XI of the Bankruptcy Act.

A motion made pursuant to Section 328 of the Bankruptcy Act, 11 U.S.C. §728, and Chapter XI Rule 11-15, 415 U.S. 1015 (1974), to convert a Chapter XI case to a case under Chapter X presents to the bankruptcy court a factual question to be resolved in the exercise of "sound discretion" and judgment. Thus, the District Court properly held that the conversion motion was to be decided in the exercise of the allowable limits of the bankruptcy judge's discretion. (A467-469). On appeal, the decision of the lower court may be reversed only if it is clear that an abuse of discretion or a plain error of law was committed. *SEC* v. *United States Realty and Improvement Co.*, 310 U.S. 434, 456 (1940); *General Stores Corp.* v. *Shlensky*, 350 U.S. 462 (1956); *SEC* v. *American Trailer Rentals Co.*, 379 U.S. 594 (1965); *SEC* v. *Liberty Baking Corp.*, 240 F.2d 511 (2d Cir.), *cert. denied*, 353 U.S. 930 (1957); *In re Lea Fabrics, Inc.*, 272 F.2d 769, 772 (3d Cir. 1959), *vacated as moot, SEC* v. *Lea Fabrics, Inc.*, 363 U.S. 417 (1960); *In re Grayson-Robinson Stores, Inc.*, 215 F. Supp. 921 (S.D.N.Y.), *aff'd*, 320 F.2d 940 (2d Cir. 1963); *SEC* v. *Canandaigua Enterprises Corp.*, 339 F.2d 14 (2d Cir. 1964); *In re Arlan's Department Stores, Inc.*, 373 F. Supp. 520 (S.D.N.Y. 1974); *In re Stonehenge Industries, Inc.*, 74 B 339 (S.D.N.Y. July 2, 1974), CCH Bankr. L. Rep. ¶65,314. In the appeal at bar, District Judge Clarie found

"that the bankruptcy judge did not abuse his discretion." (A469).

The record demonstrates that the bankruptcy court exercised sound discretion in dismissing the conversion motion. Further, no clear or plain error of law was demonstrated or established by Barnes.

The crucial consideration or "categorical imperative" in choosing between Chapter X and Chapter XI is "the needs to be served." *General Stores Corp.* v. *Shlensky, supra,* at 466. The resolution of the question depends upon whether the formulation of a plan in accordance with Chapter XI, or the use of the pervasive provisions and protracted proceedings of Chapter X, "would better serve the public and private interests concerned including those of the debtor." *General Stores Corp.* v. *Shlensky, supra,* at 465.

In making the choice between Chapters X and XI, the foregoing authorities establish that the determinative factors are:

(a) Is a simple composition of debts adequate to meet the debtor's needs?

(b) Does the debtor require more than an arrangement of the rights of unsecured creditors?

(c) Should the debtor be permitted to rehabilitate itself pursuant to the plan proposed under Chapter XI or must reorganization of the debtor's estate be governed by a disinterested trustee within the context of a prolonged and expensive Chapter X proceeding?

(d) Is there a need for an independent investigation or trustee?

The bankruptcy court carefully evaluated the needs to be served and properly concluded that Chapter XI "admirably met" the needs of Alrac, its creditors and stockholders. (A307-8, 314).

The burden of proof is upon the moving party to establish or demonstrate that adequate relief is not available to the debtor under Chapter XI of the Bankruptcy Act. Thus, Chapter XI Rule 11-15(c), *supra*, provides in part:

> "A motion made under this rule shall state why relief under Chapter XI of the Act would not be adequate and shall also conform substantially to Official Form No. 10-1."

Official Form 10-1 is an original petition under Chapter X. Accordingly, a conversion motion imposes upon the moving party the same burden as that imposed upon a petitioner for reorganization under Chapter X. Relative thereto, Section 130(7) of the Bankruptcy Act, 11 U.S.C. §530(7), requires that every Chapter X petition state:

> "the specific facts showing the need for relief under this chapter and why adequate relief cannot be obtained under chapter XI of this Act."

The motion and application of Barnes is devoid of specific facts showing the need for relief under Chapter X. Curiously, Barnes has not seen fit to include his conversion motion in the appendix filed in connection with the appeal.

As demonstrated by the record, the debt and capital structures of Alrac are simple. (A300-1, 203-6).

Substantially all of the debt of Alrac, as of the filing date, was unsecured. At the time of the filing of the Chapter XI petition, all that Alrac needed was relief from the immediate payment of its general unsecured debts, and a means to participate in the continued research and development of the Nylon-4 patents. The vehicle of Chapter XI admirably served the foregoing needs and adequately protected the interest of creditors, stockholders and Alrac itself. (A314). There existed no need for the protracted reorganization process contemplated by Chapter X. (A312-4).

The Chapter XI Plan of Alrac merely extends the time for the payment of the most substantial portion of the unsecured debt of Alrac. All creditors in Class II and Class III under the Plan will be paid 100% of their principal claims and participate in a distribution of Alrac stock; at their insistence, Class I creditors will receive an immediate cash distribution of the greater of 15% of their allowed claims or $100. Thus, the Plan meets the needs of Alrac without any complexities. It relieves Alrac from the oppressive burden of immediate payment of its major liabilities. The Chapter XI Plan also allows Alrac to participate in the fruits of the continued research and development of the Nylon-4 patents being pursued by Chevron at substantial cost. Through the Plan and the Purchase Agreement, Alrac has received and is receiving benefits from Chevron's research even before the Nylon-4 patents are developed to a commercially feasible stage. Pursuant to the Purchase Agreement and at the time of confirmation of the Plan, Alrac received from Chevron $450,000, the down payment of the purchase price. Thereafter and under the terms of the Consulting Agreement between Alrac

and Chevron, a total of $240,000 was paid to Alrac during the twelve months following the date of confirmation. Commencing January, 1976, and annually thereafter as provided in the Purchase Agreement and subject to Chevron's rights of termination, Alrac will receive minimum annual payments of $500,000 each from Chevron. The first payment was made in January, 1976.

The minimum annual payments to be made by Chevron will be sufficient to enable the installments to be paid to general unsecured creditors under Classes II and III of the Plan. In addition, if the Nylon-4 patents prove commercially feasible, Alrac will receive additional percentage payments predicated on sales volume, which will inure to the benefit of its creditors and shareholders. Manifestly, no error was committed below as the needs of Alrac are best served by the simple and expeditious provisions of Chapter XI. (A301, 303, 478).

B. Chapter X of the Bankruptcy Act Is Not Available to Alrac.

As noted by the bankruptcy court (A305), the availability of relief under Chapter X of the Bankruptcy Act is circumscribed. Chapter X Rule 10-113(a) and (b)* provide:

> "(a) *Voluntary Petition.* On the filing of a voluntary petition, the court shall enter an order approving the petition if satisfied that it complies with the requirements of Chapter X of the Act and has been filed in good faith. If not so satisfied, the court shall enter an order permitting the petition to be amended or dismissing the case.

* Chapter X Rule 10-113(a) and (b) incorporates the substance of Sections 141 and 142 of the Bankruptcy Act, 11 U.S.C. §§541, 542, which were applicable prior to August 1, 1975.

"(b) *Involuntary Petition.* If an answer to an involuntary petition is not filed by a debtor within the time provided by Rule 10-112(a)(1), and if no other party in interest has filed an answer within such time, or if any answer filed does not set forth any valid defense or objection to such petition, the court shall enter an order approving the petition if satisfied that it complies with the requirements of Chapter X of the Act and has been filed in good faith. If not so satisfied, the court shall enter an order permitting the petition to be amended or dismissing the case."

Section 146 of the Bankruptcy Act, 11 U.S.C. §546, states:

"SEC. 146. Without limiting the generality of the meaning of the term 'good faith', a petition shall be deemed not to be filed in good faith if—

"(1) the petitioning creditors have acquired their claims for the purpose of filing the petition; or

"(2) *adequate relief would be obtainable by a debtor's petition under the provisions of chapter XI of this Act;* or

"(3) *it is unreasonable to expect that a plan of reorganization can be effected;* or

"(4) *a prior proceeding is pending in any court and it appears that the interests of creditors and stockholders would be best subserved in such prior proceeding.*" (emphasis supplied).

It is self-evident that a Chapter X petition could not be filed by or against Alrac in good faith. First, as stated above, adequate relief was obtainable by Alrac under Chapter XI and a proceeding was pending for that very purpose in the bankruptcy court. Second, as found by Bankruptcy

Judge Seidman, it was and is unreasonable to expect that a plan of reorganization could be effected by Alrac under Chapter X. (A310-11).

Alrac was totally without funds. Even Barnes acknowledged that Alrac could not sustain itself.* Indeed, it was stated on his behalf that Alrac "as of August 20, 1974, maintained no corporate operations, had no income and has no opportunity to survive as a viable corporate entity and should be adjudicated a bankrupt pursuant to Chapters I through VII of the Bankruptcy Act." (A25). It appears Barnes prefers liquidation despite the severe damage that would result to creditors and stockholders of Alrac. (A311).

The case at bar is not analogous to the situations presented to the court in the *American Trailer Rentals* case, *supra* (clear indication of fraud plus the conversion of public debt to stock of another company—a *radical* adjustment), and in *In re Arlan's Department Stores, supra* (the conversion of *all* public debt to common stock of the debtor —a *radical* adjustment). It is simply not accurate that Chapter X is mandated any time the debtor has issued publicly held debt or securities. The Supreme Court dismissed that argument many years ago. *United States Realty, supra.*

The Chapter XI Plan, as stated, merely extends the payment dates of the public debt. It represents no "radical adjustment" of publicly held debt. The public debt holders entitled to vote on the acceptance or rejection of the Chapter XI Plan voted *unanimously* in favor of the Plan. This is not a case where "the wishes of the persons whose money is at stake" should be overridden or disregarded. *SEC* v.

* A180-3, 207-10, 237, 244, 261.

Canandaigua Enterprises Corp., 339 F.2d 14, 15 (2d Cir. 1964); *Grayson-Robinson Stores, Inc.* v. *SEC*, 320 F.2d 940 (2d Cir. 1963); *In re Stonehenge Industries, Inc.*, 74 B 339 (S.D.N.Y.) July 2, 1974, CCH Bankr. L. Rep. ¶65,314. Further, on at least three occasions Barnes attempted to cause the Securities and Exchange Commission to become involved in the Chapter XI case. (A226-8). Obviously, if the public interest had required a Chapter X case, the Securities and Exchange Commission would have exercised its statutory obligations by intervening in the Chapter XI case and applying for the relief sought by Barnes. However, the Commission, after reviewing the case, advised the bankruptcy judge in a letter dated December 18, 1974, that it took "no position on the Barnes motion" to convert the case to one under Chapter X. (A39, 44).

C. The Issuance of Stock Pursuant to the Chapter XI Plan and the Retention of the Interests of Existing Stockholders Is Consistent with Chapter XI and Does Not Mandate a Conversion to Chapter X.

Point VI in Barnes' brief, pages 51-52, states that a "material aspect of the proposed plan of arrangement is the issuance of 1,500,000 shares of the debtor's common stock to Class II and Class III creditors without any contribution to capital by the recipients thereof." It is then contended that this represents a reduction of the equity of existing stockholders,* including Barnes, and is "an element outside the competency of a Chapter XI * * *". In effect,

* This argument is spurious and was disposed of by Bankruptcy Judge Seidman. The bankruptcy judge noted that under the Plan, shareholders retained an interest in Alrac; whereas, if the case had been prosecuted under Chapter X, the application of the "fair and equitable" rule would have required the elimination of the existing shareholder interests. *Case* v. *Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939). Bankruptcy Act §221(2), 11 U.S.C. §621(2).

Barnes seems to be saying that a bankruptcy court does not have the power to permit the issuance of stock under a Chapter XI plan.

Barnes' argument is erroneous. Under the terms of Alrac's Plan, Class II and Class III creditors are extending the time for payment of their claims over a period of seven (7) and eleven (11) years, respectively. The issuance of common stock of Alrac is part of the consideration for the extension of payment and the waiver of interest upon the extended unsecured debt. (A261). Moreover, Chapter XI specifically contemplates the issuance of stock as part of a Chapter XI plan. Thus, Section 393a of Chapter XI of the Bankruptcy Act, 11 U.S.C. §793a, provides in pertinent part, that:

> "The provisions of section 5 of the Securities Act of 1933 shall not apply to
>
> * * *
>
> "(2) any transaction in any security issued pursuant to an arrangement [plan under Chapter XI] in exchange for claims against the debtor or partly in exchange and partly for cash and/or property * * *."

The provisions of Section 393a, *supra*, are identical to the provisions of Section 264a of Chapter X of the Bankruptcy Act, 11 U.S.C. §664a. Accordingly, the issuance of stock as part of a Chapter XI plan is within the ambit of a Chapter XI case and may be accomplished under Chapter XI as well as pursuant to Chapter X.

Point VI(c) of the Barnes brief appears to posit an argument that, because Class I creditors are receiving less than the full amount of their claims while stockholders are retaining an equity interest, a Chapter XI case is inappropriate, and the case must be converted to Chapter X so that the "fair and equitable" rule may be applied.

Barnes ignores provisions in Chapter XI which specifically contemplate that stockholders may retain their interests in a corporation despite a Chapter XI plan which does not satisfy creditors' claims in full. Section 366 of the Bankruptcy Act, 11 U.S.C. §766, provides in pertinent part, as follows:

> "Confirmation of an arrangement [a plan] shall not be refused solely because the interest of a debtor, or if the debtor is a corporation, the interests of its stockholders or members will be preserved under the arrangement [plan]."

See also, Bartle v. *Markson Bros., Inc.*, 314 F.2d 303, 305 (2d Cir. 1963); 9 COLLIER, BANKRUPTCY ¶¶8.06, 9.18 (14th rev. ed. 1976).

D. There Is No Need for an Investigation of the Management of Alrac.

Barnes introduced no evidence which would support a finding that a need for an independent investigation of the debtor's affairs or its management as contemplated by Chapter X was warranted. As noted by the bankruptcy court, Barnes himself was in control of Alrac until weeks prior to the commencement of the bankruptcy proceedings. (A311-12).

Bankruptcy Judge Seidman afforded Barnes every opportunity to introduce evidence demonstrating the need for an investigation under Chapter X. Barnes failed to sustain his burden. The bankruptcy court properly found:

> "No evidence of fraud or mismanagement suggesting the need for an independent investigation was offered. Chapter X is not needed for that purpose." (A311-2).

E. The Findings of Fact Made by the Bankruptcy Judge Are Not Clearly Erroneous and Should Not Be Disturbed.

The Memorandum and Order of Bankruptcy Judge Seidman (A299) demonstrates careful consideration and evaluation of the determinative factors presented by the motion pursuant to Section 328 and Chapter XI Rule 11-15, *supra*. Based upon the facts of the case at bar, the bankruptcy judge found:

> "The needs to be served are admirably met by the plan overwhelmingly accepted by all creditors affected. The equity of shareholders which was negative at the date of filing is preserved. The interests of the investing public are adequately protected. Since the needs to be served can be adequately satisfied in Chapter XI, it must be concluded that the proceedings need not have been brought under Chapter X of the Act, and the motion of Dr. Barnes must be dismissed, * * *." (A314).

Barnes has failed to establish any error or abuse of discretion on the part of the lower court.

It is well settled that findings of fact made by a bankruptcy judge should not be set aside unless "clearly erroneous." *In re G.E.C. Securities, Inc.*, 223 F. Supp. 861, 863 (S.D.N.Y. 1963), *aff'd*, 331 F.2d 655 (2d Cir. 1964); *Simon* v. *Agar*, 299 F.2d 853 (2d Cir. 1962).* Consistent

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* Rule 810 of the Rules of Bankruptcy Procedure, 411 U.S. 1090 (1973), entitled "Disposition of Appeal; Weight Accorded Referee's Findings", provides:

> "Upon an appeal the district court may affirm, modify, or reverse a referee's judgment or order, or remand with instructions for further proceedings. The court shall accept the referee's findings of fact unless they are clearly erroneous and shall give due regard to the opportunity of the referee to judge the credibility of the witnesses."

Cf. Fed.R.Civ.P. 52(a).

therewith, the Supreme Court has stated that a reviewing court should give due weight to the "judgment in the first instance of the judge who saw and heard the witnesses and has the feel of the case." *Cone* v. *West Virginia Pulp and P. Co.*, 330 U.S. 212, 216 (1947). Similarly, concurrent findings of a bankruptcy judge and a district court will not be set aside on appeal on anything less than a demonstration of plain mistake. *National Finance Company* v. *Marlow*, 343 F.2d 125, 126 (6th Cir. 1965); *Branch* v. *Mills & Lupton Supply Co.*, 348 F.2d 991, 992 (6th Cir. 1965). Further, it is well established that findings made by the district court will be sustained so long as there is ample support in the record. *Ackman* v. *Walter E. Heller & Co.*, 420 F.2d 1380 (2d Cir. 1969).

In the instant matter the bankruptcy judge, after a full hearing and observation of the witnesses, made findings of fact as set forth above, all of which lead to the irresistible conclusion that dismissal of the conversion motion was warranted. The findings of fact made by Bankruptcy Judge Seidman are not clearly erroneous. (A69). Indeed, they are unassailable.

Based upon the incontrovertible findings of fact, the dismissal of the conversion motion and the making of the Conversion Order must be affirmed in the interests of all creditors and shareholders and Alrac itself.

II

COMPLIANCE WITH THE REQUIREMENTS OF CHAPTER XI ENTITLED ALRAC TO AN ORDER CONFIRMING THE PLAN.

A. The Applicable Statutory Provisions

Pursuant to the provisions of Section 366 of the Bankruptcy Act, 11 U.S.C. §766:

> "The court *shall* confirm an arrangement [plan] if satisfied that—
>
> (1) the provisions of this chapter have been complied with;
>
> (2) it is for the best interests of the creditors and is feasible;
>
> (3) the debtor has not been guilty of any of the acts or failed to perform any of the duties which would be a bar to the discharge of a bankrupt; and
>
> (4) the proposal and its acceptance are in good faith and have not been made or procured by any means, promises, or acts forbidden by this Act.
>
> *Confirmation* of an arrangement [plan] *shall not be refused solely because the interest* of a debtor, or if the debtor is a corporation, the interests of its stockholders or members will be preserved under the arrangement [plan]." (emphasis supplied)

In the instant matter the Order of Confirmation and the Memorandum and Order dated December 30, 1974 establish that the bankruptcy court was satisfied that:

1. The provisions of Chapter XI had been complied with.

2. The Plan had been proposed by Alrac and its acceptance was procured in good faith, and not by any means, promises or acts forbidden by law.

3. The Plan is for the best interests of the creditors of Alrac and is feasible, and Alrac was not guilty of any of the acts or failed to perform any of the duties which would have been a bar to the discharge of a bankrupt. (A315-6).

The findings made by the bankruptcy court were clearly supported by the record as demonstrated above. Certainly none of the findings is clearly erroneous. These findings, together with the conclusions of the bankruptcy court entitled Alrac to an order of confirmation of the Plan as a matter of law. *In re KDI Corp.*, 477 F.2d 742 (6th Cir. 1973).

B. The Chapter XI Plan of Alrac Meets the Test of Feasibility Under Section 366(2) of the Bankruptcy Act.

Barnes does not dispute that the Chapter XI Plan is for the best interests of creditors. He cannot controvert that creditors will receive more under the confirmed Plan than they could realize from a liquidation of Alrac in ordinary bankruptcy proceedings. (A310-11). *In re Stanley Karman, Inc.*, 279 F. Supp. 828 (S.D.N.Y. 1967).

The only substantive objection to the Order of Confirmation is the assertion in Point IV of Appellant's brief that the Plan is not "feasible," as required by subdivision 2 of Section 366 of the Bankruptcy Act. However, Barnes misconceives the meaning of "feasible" within the context of Chapter XI.

The definition of the term "feasible" in Chapter XI is different from the definition of that term in proceedings under Chapter X. A Chapter XI plan is feasible if there is a *reasonable expectation* that payments to general unsecured creditors will be made when due. It does not portend the emergence of an economically viable entity. As stated in *In re Slumberland Bedding Co.*, 115 F. Supp. 39, 42 (D. Md. 1953):

> "* * * the confirmation of the plan should not be construed as a finding by the court that the business in the future will be successful. Creditors who may subsequently deal with the debtor must determine that for themselves."

Accordingly, for the purposes of Chapter XI a determination of feasibility does not require a finding that the debtor will be a viable business entity for the indefinite future. Instead, feasibility means that "creditors must be assured of receiving what is promised them under the arrangement." *In re American Trailer Rentals Co.*, 325 F.2d 47, 53 (10th Cir. 1963), *rev'd on other grounds*, 379 U.S. 594 (1965).

As stated, the Chapter XI Plan of Alrac is based upon the Purchase Agreement and related agreements between Alrac and Chevron. The payments that are to be made by Chevron pursuant to the Purchase Agreement could total more than $8,000,000 and will be made at the rate of $500,000 per year. The initial payment which was due in January, 1976 has been paid. In contrast, the distributions to be made to creditors under the Plan are less than $500,000 per year. (A29, 30, 36, 38). Thus, the creditors of Alrac are assured of receiving the distributions contemplated by

the Plan unless the Nylon-4 patents have no commercial utility. In connection therewith, it must be noted that Chevron did not exercise its option to terminate the Purchase Agreement at the end of the first year. The next option period is approximately two years hence.

The determination of feasibility of a Chapter XI plan is one peculiarly within the province of the bankruptcy court. Accordingly, this Court has determined that the acceptance of a Chapter XI plan by the creditors affected thereby and the determination by the bankruptcy court that the plan is feasible should not be disturbed by an appellate court even if a portion of the plan appears "doubtful." *Bartle* v. *Markson Bros., Inc.*, 314 F.2d 303, 305 (2d Cir. 1963). Upon the facts presented at the hearing on confirmation, Bankruptcy Judge Seidman found that the Chapter XI Plan of Alrac is feasible. To challenge that finding, all that Barnes submits is a statement, made for the first time by his attorney during oral argument in the District Court, to the effect that two large, unresolved claims may upset the Plan. This assertion was not presented in the bankruptcy court and the record is devoid of any support therefor. (Appellant's Brief, pp. 44-5). Alrac demonstrated below that it will be able to meet its obligations under the Plan. There is no evidence to the contrary.

III

THE ALRAC PLAN WAS ACCEPTED BY THE REQUISITE MAJORITY OF CLASS I CREDITORS.

A. The Acceptance of the Plan by Class I Creditors

The main thrust of the Barnes brief (pp. 22-43) is that the Plan was not accepted by the requisite majorities of Class I creditors. This contention is based upon the assertion of Barnes (who is not a Class I creditor) that the claims of three Class I creditors (Edward M. Peters ("Peters"), Mitsubishi International Corporation ("Mitsubishi") and Serico Electric Co., Inc. ("Serico")) were not stamped "Filed" by the bankruptcy court until after that court, at a hearing on December 20, 1974, found that the Plan had been accepted by a majority of the creditors entitled to vote. (A64, 68-83).

Barnes fails to take into account the unchallenged fact that the claims of the aforesaid creditors were physically present and before the bankruptcy court on December 20, 1974. He ignores the fact that they were included in the tally made by the attorneys for the Creditors' Committee and were inspected and examined *without objection* by Barnes himself as well as his attorney. The record of the hearing held on December 20, 1974, establishes beyond doubt the acceptance of the Alrac Plan by the requisite majority of Class I creditors. (A64-65).

At that hearing, the co-attorney for the Creditors' Committee, Mr. Krick, reported that of the forty-five (45)

Class I creditors entitled to vote, thirty-two (32) voted in favor of accepting the Plan and that such accepting Class I creditors represented an overwhelming majority of the amount of creditor claims of the Class I creditors entitled to vote.

The tally of acceptances prepared on behalf of the Creditors' Committee listed the claims of the respective creditors and the votes cast. (A92-105). Including the acceptances of the three claimants, 28 Class I creditors with claims totaling $62,104.01 accepted the Plan and only 13 Class I creditors with claims aggregating $26,142.72 rejected the plan. Barnes and his attorney examined the tally sheets and the underlying claims. Thereafter, his attorney agreed that the requisite majorities of Class I creditors had accepted the Plan.

> "THE COURT: Are there any claims that are [have] accepted that you have objections to?
>
> "MR. EVANS [Attorney for Barnes]: With respect to the acceptances of class two and three there are no errors of significance in those areas. We would ask obviously that we would be furnished the solicitations that went out.
>
> "THE COURT: Yes.
>
> "MR. KRICK [Co-Attorney for Creditors' Committee]: With respect to the class one claims, it appears to be *some discrepancy, none of major significance*.
>
> "THE COURT: How many claims?
>
> "MR. KRICK: My girl gave me assistance. It appears that the same persons have filed numerous claims which I think my girl has added. There is one person who filed three claims. I think she counted them three times. There is another consenting creditor listed twice, so this would reduce the amount.

"MR. EVANS: You found 28 in favor, 13 opposed. Disregarding all creditors included for the mass amount [sic].

"THE COURT: That left 45.

"MR. KRICK: That should have been 42, I guess.

"MR. EVANS: 41 or 2.

"THE COURT: And there are still 32 yes's?

"MR. EVANS: 28 yes's left.

"MR. KRICK: I'll file a corrected statement for class one for the record.

"THE COURT: That changes the arithemetic [sic].

"MR. EVANS: *It doesn't change the result obviously.* There was an understanding that whatever letter was sent out by the creditors committee would be presented.

"THE COURT: Well, it appears that a majority in number and amount of creditors have accepted the plan. Accordingly, I will find that the plan has been accepted and I'll declare the first meeting of creditors closed. * * *" (emphasis supplied) (A64-65).

Barnes does not dispute, nor can he, the fact that the claims of Peters, Serico and Mitsubishi were physically present in the courtroom and were examined and inspected by him and his attorney. Exhibit II to the "Computation of Vote on Arrangement" lists such claims. (A92). Surely, if the claims and acceptances did not exist, Barnes and his attorney would have brought that fact to the attention of the bankruptcy court.

Nevertheless, Barnes now asserts that the bankruptcy court only intended to allow claims which had been "Filed"; and he *assumes*—without any basis in the record—that the bankruptcy judge thereby meant the claims must be stamped "Filed" by the clerk of the court rather

than "Filed" with or "submitted" to the Creditors' Committee in advance of the hearing or "Filed" with or "submitted" to the court at the time of the hearing. Yet there is nothing whatsoever in the record to support the arguments made by Barnes. Indeed, the record as a whole shows that the bankruptcy judge was relying on the claims and tally sheets which the Creditors' Committee presented to the court as well as the statements of the attorney for Barnes. (A64-65). At no time during the hearing did Barnes or anyone else even ask what papers had been stamped "Filed" by the clerk. Barnes even admits that filing with the clerk is only a "ministerial act." (Appellant's Brief, p. 25).

There is simply no basis for Barnes now to contend that the bankruptcy judge only gave him 64 minutes to examine the claims. (Appellant's Brief, p. 20). The record shows that the bankruptcy court actually granted Barnes as much time as he wanted (A59-64), but that his attorney and he finished the examination in 64 minutes. During that time they had a full opportunity to compare each and every claim and acceptance with the Computation of Vote submitted by Alrac and the Creditors' Committee; they also had every opportunity to examine the filing marks on the claims and make such objections as they then deemed appropriate. No objections were made by Barnes on the basis of existence or lack of a stamped legend "Filed".*

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* The practice in the bankruptcy court for the District of Connecticut is to treat creditors' acceptances which are transmitted to counsel for the creditors' committee in Chapter XI cases as duly filed for purposes of showing acceptance of a plan. *See, In re TM*

(footnote continued on next page)

B. A Claim, Sufficient on Its Face, Entitles the Claimant to Vote on All Matters Presented to Creditors Unless Objection Is Interposed Thereto.

Section 57d of the Bankruptcy Act (11 U.S.C. §93d) provides:

> "Claims which have been duly proved *shall be allowed upon receipt by or upon presentation to the court, unless objection to their allowance shall be made by the parties in interest* or unless their consideration be continued for cause by the court upon its own motion * * *" (emphasis supplied).

Similarly, Bankruptcy Rule 207(a), 411 U.S. 1028 (1973), provides that a creditor may vote at a meeting if he has filed a proof of claim at or before the meeting unless objection is timely made or the claim is insufficient on its face. Under Bankruptcy Rule 306(b), 411 U.S. 1046 (1973), a claim is deemed allowed unless an objection is made thereto. Appellant does not contend that any of the three subject claims is insufficient on its face. Furthermore, Barnes' attorney raised no objections to any of the three claims after examining each of them. Objections to the vote of a claim must be made at the time the vote is taken or the objection is waived.

Systems, Inc., CCH Bankr.L.Rep. ¶65,539 (D.Conn. 1974). (A copy of the *TM Systems* opinion, in full text, is annexed to Alrac's sur-reply brief filed in the District Court, document no. 77 in the supplemental index to the record on appeal.) In *TM Systems*, the bankruptcy judge found that the creditors' committee was charged under §339 of the Bankruptcy Act, 11 U.S.C. §739 and Chapter XI Rule 11-28(a) "to collect and file with the court acceptances of the arrangement proposed". This was deemed to be "timely delivery" and an "acceptable filing of the claims," even though the claims were not received or stamped as filed by the clerk.

The governing principle is that:

> "an objection to the vote of a claim must be timely. *It may not be made after the vote has been taken. Failure to object before the vote is taken is deemed a waiver of the objection. Curtis Candy Co.* v. *Brent*, 6 Cir., 1926, 16 F.2d 119; *In re Stradley & Co.*, D.C.N.D. Ala., 1911, 187 F. 285; 3 Collier, supra at p. 55." *In re Autocue Sales & Distributing Corp.*, 148 F. Supp. 685, 687 (S.D.N.Y. 1957). [Emphasis supplied.]

Consequently all three claims were properly allowed and entitled to vote to accept the Chapter XI Plan.*

C. The Inclusion of the Peters Claim Alone Establishes Acceptance of the Plan by Class I Creditors.

Assuming, *arguendo*, that the date of a clerk's stamping is relevant on this appeal, it is evident from the record

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* Under Bankruptcy Rule 509, 415 U.S. 1058 (1974), made applicable in Chapter XI cases by Chapter XI Rule 11-33(b), 415 U.S. 1024 (1974), and Bankruptcy Rule 302(b), 411 U.S. 1042 (1973), the belated nature of appellant's present assertions is particularly significant. Bankruptcy Rule 509 provides:

> "(c) *Error in Filing.* A paper intended to be filed but erroneously delivered to the trustee or receiver, or the attorney for either of them, or to the district judge, referee, or clerk of the district court, shall, after the date of its receipt has been noted thereon, be transmitted forthwith to the proper person. In the interest of justice, the court may order that the paper shall be deemed filed as of the date of its original delivery."

The claims and acceptances of Peters, Mitsubishi and Serico were before the court on December 20, 1974. (A92). Indeed, the Peters' claim bears the "received" stamp of the clerk. (A68, 70, 72, 74 and 78). The claims of Mitsubishi and Serico were delivered to Mr. Krick, co-attorney for the Creditors' Committee. (A92). Mr. Krick in his capacity as co-attorney for the Creditors' Committee acted as an officer of the court and a fiduciary. His status is the equivalent of an attorney for a receiver or trustee. In that context, Bankruptcy Rule 509 explicitly provides that the court may deem the claims properly filed as of the date of their delivery.

that one of the claims was received and filed well before the hearing and that it alone was sufficient to sustain the finding of the bankruptcy court of the acceptance of the Plan. Edward Peters filed two substantially identical proofs of claim, both in the amount of $18,941.43. (A78, 83, Claims Nos. 241, 274). The two proofs of claim are identical in substance and, obviously, they were counted as one claim by the Creditors' Committee; there was no double counting made or alleged. It is undisputed that Claim No. 241 was received, and marked "Received," by the clerk of the bankruptcy court on December 5, 1974 (A78) and again on December 19, 1974. (A78). Thus, at the time of the December 20 hearing, it was clearly "Filed" even in the specialized sense urged by Barnes. Rule 5(e), Fed. R. Civ. Proc.; 2 MOORE'S FEDERAL PRACTICE ¶5.11 (2d ed. 1975). *See also, Ward* v. *Atlantic Coast Line Railroad Co.*, 265 F.2d 75 (5th Cir. 1959), *rev'd other grounds*, 362 U.S. 396 (1960); *In re Imperial Sheet Metal, Inc.*, 352 F. Supp. 1149, 1152 (M.D. La. 1973); *In re Nimz Transportation, Inc.*, 505 F.2d 177, 197 (7th Cir. 1974); *Johansson* v. *Towson*, 177 F. Supp. 729, 732 (M.D. Ga. 1959); *In re Pigge*, CCH Bankr. L. Rep. ¶65,984 (4th Cir. June 11, 1976).

The Peters claim by itself ($18,941.43) is sufficient to support the finding of the bankruptcy court that the Alrac Plan was accepted by the requisite majorities of the Class I creditors, as set forth below:

Class I Creditors	*Initial Computation 12/20*	*Amended Computation 12/26*	*Including Peters* but excluding Mitsubishi** and Serico†*
Number filed	58	55	
(Less than $100)	13	12	
Entitled to vote	45	43	41
Voting in favor	32	30	28
Not in favor	13	13	13
Amount filed	$93,335.09	$88,156.73	$66,787.12
Voting in favor	67,192.37	62,014.01	40,664.40
Not in favor	26,142.72	26,142.72	26,142.72

* Peters — $18,941.43 — first marked received in Clerk's office on December 5.

** Mitsubishi — $16,191.25 — marked received December 23.

† Serico — $ 5,178.36 — marked received December 23.

$40,311.04

Total of Serico and Mitsubishi $21,369.61

Thus, omitting the claims of Mitsubishi and Serico, the number of Class I creditors accepting the Plan is 28 out of a total of 41 entitled to vote (a majority in number) and the aggregate dollar amount of the claims of such creditors is $40,664.40. The total dollar amount of all claims of Class I creditors entitled to vote is $66,787.12. Thus, a majority in amount of Class I creditors accepted the Plan. Accordingly, the provisions of Section 362(1) of the Bankruptcy Act, 11 U.S.C. §762(1), were satisfied.

D. In Accordance With the Bankruptcy Act, Wages Entitled to Priority May Not Exceed $600 and Must Have Been Earned Within Three Months of the Filing of the Petition in Bankruptcy.

Beginning at page 37 of his brief, Barnes asserts that the Peters' claim is not eligible for voting because it is a priority wage claim. This assertion is predicated upon the fact that someone, presumably the clerk, wrote "priority" in longhand on the top of Peters' claim No. 241. (A78).

The essence of the contention made by Barnes is that the mere notation upon a proof of claim that it is a priority claim, without more, means that that claimant is disenfranchised from voting as to any Chapter XI plan. This argument ignores the provisions of Section 64 of the Bankruptcy Act, 11 U.S.C. §104, entitled "Debts which have Priority." Subsection (2) of Section 64a specifies the extent to which wage claims filed against a debtor may have priority. It governs all wage claims in Chapter XI cases. Section 64a(2), in pertinent part, limits priorities for wages to:

> "wages and commissions, *not to exceed $600* to each claimant, which have been *earned within three months before the date of the commencement of the proceeding* * * *." [Emphasis supplied.]

The bankruptcy case involving Alrae commenced on August 12, 1974. The claim of Peters is in the sum of $18,941.43, an amount substantially in excess of the $600 maximum priority allowable. Further, the Claim states that it is for "Back Wages as per contract for 1972, 1973." Obviously, the wages described could not have been earned

within three months of August 12, 1974. Accordingly, the Peters claim does not qualify as a priority wage claim but as a general, unsecured claim falling within Class I of Alrac's Chapter XI Plan.

Furthermore, even if a portion of the Peters claim were entitled to priority status, Peters would still be entitled to vote for the Alrac Chapter XI Plan as to that portion which is clearly not entitled to priority status, *i.e.*, $18,341.43. Rule 207(c) of the Rules of Bankruptcy Procedure, *supra*, which is ignored by Barnes, provides:

> "(c) *Creditors with Secured Claims or Priority Claims.* A creditor holding a claim which is secured or has priority shall be entitled to vote such claim only to the extent the claim exceeds the value of his security or the amount of his priority."

The Bankruptcy Act and the Rules of Bankruptcy Procedure establish that all or at least $18,341.43 of the claim of Peters was properly included within Class I for the purposes of the Alrac Chapter XI Plan. Excluding $600 from the Peters' claim would change the arithmetic but not the result.

E. Peters' Claims Fall Into Class I.

Barnes attacks Peters' right to vote as a Class I creditor. It is argued that Peters filed several claims which, if added together, aggregated more than $20,000. Therefore, Barnes contends that Peters was not entitled to vote as a Class I creditor.

Appellant can point to nothing in the Alrac Plan which prohibits a creditor who might have been entitled to ag-

gregate his claims, and thereby fall in Class II, from electing to file the claims separately and thereby qualify them under Class I. This would allow him to take an immediate 15% payment of his allowed claim rather than wait over an extended period of time in the hope of a higher recovery. Again, if Barnes had any objections to this election, they should have been raised before the bankruptcy court. *See* discussion at pp. 33-5, *supra*.

The Barnes objections are without substance. The record contains more than adequate evidence to support the finding that a majority of the creditors voted in favor of the Plan. The District Court was completely justified in holding that the findings of the bankruptcy court were not clearly erroneous.

F. The Mitsubishi and Serico Claims Are Properly Included in the Computation of Acceptances of the Plan by Class I Creditors.

The votes of Serico and Mitsubishi should not be disregarded simply because the stamp of the clerk was not impressed upon them until December 23, 1974, the next business day, Monday, following the hearing before the bankruptcy court. These claims were before the bankruptcy court and they were allowed and counted without objection by Barnes or his attorney during the hearing of December 20, 1974. (A55-9, 64-5, 90, 92, 107, 109). To argue the contrary on the basis of the delay in stamping the claims is far too frail a reed upon which to overturn the confirmation of the Alrac Plan and subject creditors to the resultant prejudice and damage to their vested rights and expectations. If an error had occurred in the filing

of the aforesaid claims, such error was harmless; was waived by Barnes' failure to object at the proper time; and, if timely raised, could have been cured by the provisions of Rule 509 of the Rules of Bankruptcy Procedure, 411 U.S. 1058 (1973). *See* footnote at p. 35, *supra*.

Finally, it is patent that Barnes is seeking to exalt form over substance. When Barnes urged precisely the same argument as to the three claims in the District Court, that Court inquired:

> "Suppose that were done all over again; let's suppose your claim was valid, and it was done all over again. Would it be any different today? Have any of these people [Peters, Mitsubishi and Serico] changed their position?" (A337).

The attorney for Barnes responded:

> "No, your Honor. None of the three to whom I have made reference have changed their position." (A337).

It is respectfully submitted that the contentions of Barnes are spurious and devoid of substance.

IV

THE AMENDMENT TO THE PLAN PROVIDING FOR A LEGEND ON THE SHARES OF STOCK TO BE ISSUED PURSUANT TO THE PLAN DID NOT MATERIALLY AND ADVERSELY AFFECT CREDITORS.

Section 363 of the Bankruptcy Act, 11 U.S.C. §763, provides, in part:

> "Alterations or modifications of an arrangement may be proposed in writing by a debtor, with leave of the court, at any time before the arrangement is confirmed; * * *."

Chapter XI Rule 11-39, 415 U.S. 1029 (1974), provides, in part:

> "* * * If the court finds that the proposed modification does not materially and adversely affect the interest of any creditor who has not in writing accepted it, the modification shall be deemed accepted by all creditors who have previously accepted the plan."

Alrac proposed a modification of the Plan consistent with applicable law and the suggestions of the Securities and Exchange Commission as set forth in the letter of the Commission to Bankruptcy Judge Seidman, dated December 18, 1974. (A39). The bankruptcy court found and determined that the modification did not materially and adversely affect the interests of the creditors in Classes II and III who had accepted the Alrac Plan.* (A273). Rather, the bankruptcy court determined that the modification reflected the existing law and conferred a benefit upon the Class II and Class III creditors of Alrac. (A273-274).

The modification provides that the stock to be issued to Class II and Class III creditors shall bear the following legend:

> "The shares represented by this certificate have not been registered under the Securities Act of 1933 and may not be sold, assigned, or transferred unless a registration statement under the Securities Act of 1933 is in effect or an exemption from registration is available."

---

* Bankruptcy Judge Seidman found the amendment "not prejudicial and that it can be accepted without the necessity of notice to creditors." (A273). The expression "not prejudicial" may be equated to not "materially adverse." *In re Highland Realty, Inc.*, 371 F.Supp. 62 (D.P.R. 1973); *Eddy* v. *Prudence Bonds Corp.*, 165 F.2d 157, 162 (2d Cir. 1964), *cert. denied*, 333 U.S. 845 (1948).

This legend to be impressed upon the shares of common stock of Alrac distributable to Class II and Class III creditors pursuant to the Plan, is reflective of existing law and does not represent a modification of rights. Barnes concedes at p. 49 of his brief that the legend "imposed no new restriction on the stock * * *." Therefore, to argue that it halved the value of the stock is unfounded unless one intends to foist the stock on an unknowledgeable purchaser.

Moreover, the obligation undertaken by Alrac to use its best efforts to register the shares of stock, at its own expense, within two years from the date of confirmation or to obtain an exemption therefrom, is an improvement upon the Plan as originally proposed. Bankruptcy Judge Seidman carefully considered the proposed modification and amendment. He concluded that a benefit was conferred upon the Class II and Class III creditors under the Plan. (A273-274).

Despite the obvious benefit as found by Bankruptcy Judge Seidman, Barnes submits that the above modification represents a material and adverse change in the Plan. He cites *Downtown Investment Ass'n* v. *Boston Metropolitan Buildings, Inc.*, 81 F.2d 314 (1st Cir. 1936) and *Eddy* v. *Prudence Bonds Corp.*, 165 F.2d 157 (2d Cir. 1947), *cert. denied*, 333 U.S. 845 (1948). It is submitted that the foregoing cases are inapposite. In those cases, there was (or otherwise would have been) threatened, clear and actual prejudice. Such is not the case in the appeal at bar.

The modification to the Plan was made as a result of the suggestion of the Securities and Exchange Commission. The Commission furnished the bankruptcy court with a

copy of the order of confirmation utilized in *In re Synergistics, Inc.*, No. 70-1251 (D. Mass., December 22, 1971), as demonstrating the use of a legend to conform with existing law. (A39). It is obvious that if the shares of stock to be issued pursuant to the Plan were subject to restrictions as to transferability, the mere statement of that fact by way of legend impressed upon the stock certificates does not adversely affect the rights of accepting creditors. Consequently, the bankruptcy court properly determined that the modification was not prejudicial. Therefore it cannot be deemed to have had a material or adverse impact upon Class II or Class III creditors. The nominal value of the Alrac stock, the existence of registration rights, and the admonition of the Commission not to allow Chapter XI "to promote trafficking in unregistered stock" were among the factors considered below in reaching the finding that the modification was not material or adverse to Class II and Class III creditors. (A41, 273-4, 312-3).

V

THE TRANSFER AND SALE OF THE NYLON-4 PATENTS ARE NOT AFFECTED BY THE PENDING APPEAL FROM THE ORDER OF CONFIRMATION.

Rule 805* of the Rules of Bankruptcy Procedure, entitled "Stay Pending Appeal", states:

> "A motion for a stay of the judgment or order of a referee, for approval of a supersedeas bond, or for other relief pending appeal must ordinarily be made in the first instance to the referee. Notwithstanding Rule

* Bankruptcy Rule 805, 411 U.S. 1088 (1973), is made applicable in Chapter XI cases by Chapter XI Rule 11-62, 415 U.S. 1038 (1974).

762 but subject to the power of the district court reserved hereinafter, the referee may suspend or order the continuation of proceedings or make any other appropriate order during the pendency of an appeal upon such terms as will protect the rights of all parties in interest. A motion for such relief, or for modification or termination of relief granted by the referee, may be made to the district court, but the motion shall show why the relief, modification, or termination was not obtained from the referee. The district court may condition the relief it grants under this rule upon the filing of a bond or other appropriate security with the referee. A trustee or receiver may be required to give a supersedeas bond or other appropriate security in order to obtain a stay when taking an appeal."

Chapter XI Rule 11-62, entitled "Appeal to District Court," provides, in pertinent part, as follows:

"(2) The following shall be added to Rule 805 [of Part VIII of the Bankruptcy Rules]:

'Unless an order approving a sale of a property or issuance of a certificate of indebtedness is stayed pending appeal, the sale to a good faith purchaser or the issuance of a certificate to a good faith holder *shall not be affected* by the reversal or modification of such order on appeal whether or not the purchaser or holder knows of the pendency of the appeal.'" [emphasis supplied]

The Alrac Plan provides in Section F thereof as follows:

"Upon the confirmation of this Arrangement, all of the properties and other rights which are the subject of, and are more fully described in that certain Purchase Agreement dated August 14, 1974, by and between Alrac Corporation and Chevron Research Company and Chevron Chemical Company and the attach-

> ments thereto, shall be transferred to and vested in Chevron Research Company free and clear of all liens, encumbrances, claims or licenses of whatsoever kind and nature, subject only to the terms and provisions of the said Purchase Agreement and the attachments thereto and the agreements referred to therein; and the Purchase Agreement and the attachments thereto shall become immediately effective." (A30-31).

The Order of Confirmation provides in Paragraph D thereof, as follows:

> "All of the property and other rights which are the subject of and more fully described in that certain Purchase Agreement dated August 14, 1974, * * * are transferred to and vested in Chevron Research Company free and clear of all liens, encumbrances, claims or licenses of whatsoever kind or nature, subject only to the terms and provisions of that certain Purchase Agreement and the attachments thereto and agreements referred to therein; and that certain Purchase Agreement and the attachments thereto shall become immediately effective as set forth in Section F. of the Amended Agreement." (A317-8).

Consistent with the foregoing, the Purchase Agreement between Alrac and Chevron became immediately effective upon the entry of the Order of Confirmation. The Order of Confirmation constituted an approval of the sale and transfer of the Nylon-4 patents to Chevron. (A465-6). In consideration thereof, Chevron paid to Alrac the initial payment of $450,000. (A478). In accordance with the purchase and sale transaction, Chevron has made certain monthly payments to Alrac totalling $240,000 since December 31, 1974. Chevron has also paid the $500,000 installment payment which was due in January, 1976.

Subsequent to the entry of the Order of Confirmation, Barnes made no application pursuant to Bankruptcy Rule 805, *supra*, for a stay pending appeal. He took no action to enjoin the implementation of the Order of Confirmation and the transfer and sale of the Nylon-4 patents pursuant to the Order of Confirmation and the Plan. Further, he did not file a supersedeas bond pending the appeal.

Consequently, the provisions of Chapter XI Rule 11-62 govern, and the District Court found that "the outcome of the appeal cannot affect the sale of patents to Chevron . . . ." (A465).

Chapter XI Rule 11-62 is, in effect, a codification of existing law. Confidence in the stability and integrity of judicial sales must be preserved. *Smith* v. *Juhan*, 311 F.2d 670 (10th Cir. 1962). Once a debtor or trustee has consummated a sale, it is axiomatic that such sale and the transfer of the property pursuant thereto cannot be set aside unless the appellant procures a stay pending appeal or files an appropriate supersedeas bond. *Taylor* v. *Austrian*, 154 F.2d 107 (4th Cir. 1946); *Kelaghan* v. *Industrial Trust Co.*, 211 F.2d 134 (1st Cir. 1954); *In re Abingdon Realty Corp.*, CCH Bankr. L. Rep. ¶65,879 (4th Cir. 1976).

The underlying principle of Chapter XI Rule 11-62 is based upon sound policy. In the absence of such a rule, there would be no reason for an appellant to undertake the cost and expense of obtaining a supersedeas bond. "[T]o hold otherwise would be to give this appeal, for which no security analogous to an injunction bond has been posted, the practical effect of an injunction." *Brill* v. *General Industrial Enterprises, Inc.*, 234 F.2d 465, 469 (3d Cir. 1956).

The practical effect of the application of Chapter XI Rule 11-62, by reason of Barnes' failure to comply with Bankruptcy Rule 805, *supra*, is to render the instant appeal academic. Accordingly, and for all of the reasons stated, the Order of Confirmation should not be disturbed.

Conclusion

The Order of the District Court should be affirmed in all respects.

Respectfully submitted,

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July 26, 1976

Service of 8 copies of the
within Brief is hereby
admitted this 27th day of
July 1976
Signed Amend & Amend by Richard L Schmeel
of Counsel to
Attorney for Appellant

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Signed Robert C. Bell, Jr. by Richard L Schmeel
Attorney for Appellant

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